

## THE HEAVY COSTS OF THE GOVERNMENT'S PARTNERSHIP WITH DEBT COLLECTION AGENCIES

© Copyright 2014, National Consumer Law Center, Inc.

### EXECUTIVE SUMMARY

The U.S. Department of Education refers every eligible defaulted debt to one of 22 private collection agencies. Despite the history of consumer abuses by the collection industry, the United States government hires collectors not only to collect money, but also to communicate with borrowers about options to address student loan debt and to help borrowers resolve their debt.

There is inherent conflict in these dual responsibilities. Communicating with borrowers about options and helping them resolve their student loan debts is simply not the primary mission of collection agencies. Debt collectors are not adequately trained to understand and administer the complex borrower rights available under the Higher Education Act. To compound the problem, the government has turned a blind eye to borrower complaints and known abuses by debt collection agencies.

Although the government must balance the need to collect student loans with the need to assist borrowers, the current system heavily favors high pressure collection and debt collector profits to the detriment of financially distressed borrowers seeking the help they so desperately need.

This report focuses on the government's private debt collector program, first describing how the current system works and what it costs. Next, the report details the incentive compensation system and how this system leads to abuses by private collection agencies. It then compares the Department of Education's evaluation of its private collection agencies with complaints to the Federal Trade Commission and the Better Business Bureau. Finally, the report explains how the structure of Federal Student Aid (FSA) enables widespread violations of consumer protection laws and prevents borrowers from accessing their rights. The report concludes with recommendations for reform.

#### *Key Findings*

##### *The Collection Agency Contractor System Costs Billions*

The costs of relying on private collectors are enormous for borrowers, taxpayers, and society. Department projections show that taxpayers and student loan borrowers are projected to pay over \$1 billion in commissions to private student loan debt collectors in 2014, growing to over \$2 billion by 2016.

There are extraordinary penalties for borrowers who go into default. When a borrower has a defaulted federal student loan (a loan that is more than 270 days past due), the government can seize certain income and assets from the borrower without a court order. Low-income borrowers are especially harmed because the government often seizes benefits, such as the Earned Income Tax Credit, that are aimed at promoting economic mobility. Moreover, a borrower in default is prevented from receiving further aid (including Pell grants) to return to school.

### *Government Incentives Drive Collection Agency Behavior and Harm Consumers*

Recent changes in the compensation system demonstrate the relationship between the incentives and borrower outcomes. The law clearly states that the monthly payment for loan rehabilitation (an important right for borrowers seeking to get out of default) should be based upon the borrower's circumstances. However, prior to July 2012, it was nearly impossible for borrowers to negotiate a rehabilitation payment amount that was less than a percentage of the loan balance (called balance sensitive rehabilitation). This rampant violation of consumer rights occurred in an era when the government's collection contract only paid the full commission rate if the collector-induced rehabilitation payment amounts were at least the balance sensitive amount. In July 2012, the Department amended the contracts to allow contractors to earn the full commission for arranging *either* a balance sensitive rehabilitation or one that calculated payments based on the borrower's actual income.

The data shows that the number of rehabilitations skyrocketed after the change in the incentives. The rules and regulations did not change during this period. The *only* change was the way that the collection agencies were paid. The result was more affordable and successful rehabilitations. Bottom line: money, not the law, drives collection agency behavior.

The report also discusses how the collection incentives are part of an overall structure that creates confusion about who the collection agencies are working for. In fact, by its very nature, the Department's Federal Student Aid (FSA) agency has multiple constituencies. Students are only one of these groups and are often the least powerful.

The performance based organization (PBO) structure is to blame for some of the ongoing conflicts of interest within the Department. For example, FSA is supposed to act on behalf of its customers but there is no single priority group of customers. The category includes not only students, but also financial institutions and schools. The FSA by its very nature has multiple constituencies, often with conflicting needs and goals.

### *Problems with the Collection Agency Evaluation System*

The Department rewards the agencies based on the total amount of money collected from student loan borrowers, regardless of the harm caused to student loan borrowers and regardless of legal compliance. Ironically, this same system, which lets collection agencies break the law without consequence, imposes severe consequences on borrowers when they get into trouble and fall behind on their payments.

The Department evaluates the collection agencies it contracts with on a quarterly basis using a metric called the Competitive Performance and Continuous Surveillance (CPCS) score. The Department uses the CPCS score to determine the allocation of new accounts, instilling fierce competition among contractors for hundreds of millions of dollars in commissions. The three contractors with the highest score receive additional performance compensation, which can add up to several million dollars a year for the top contractor.

This report documents the Department of Education's pattern of disregarding the experiences of student loan borrowers in collections. The Department frequently cites a low volume of complaints to support its claims of effective oversight. However, documented problems with the complaint system have led to the systematic underreporting of complaints by collection agencies and the Department.

The National Consumer Law Center (NCLC) analyzed the CPCS scores for Fiscal Year 2012 and compared them to local Better Business Bureau complaint records and complaints submitted to the Federal Trade Commission. Because of the Department of Education's inadequate system of collecting complaints, NCLC was forced to use proxies for evaluating the Department of Education's compensation and evaluation system for its private collection agencies.

NCLC found the following problems with the Department's evaluation system:

- There is no relationship between the Department's scores and the volume of complaints;
- The Department has never deducted points from a collection agency for complaints;
- The Department failed to use the performance category that incorporates borrowers' experiences; and
- The Department has given collection agency NCO Group, Inc. the highest rank among the PCAs collection agencies several times in recent years, despite NCO's legal troubles with federal and state regulators.

### *Government Regulators Asleep at the Wheel*

In 2014, separate reports by the Government Accountability Office (GAO) and the Department's Office of the Inspector General (OIG) found that Department of Education oversight of its collection agencies was woefully insufficient. These problems are consistent with the many problems that NCLC has documented and sent to Department staff over the past several years.

Specifically, OIG found that the Department's Federal Student Aid office failed to monitor borrower complaints against its collection agencies, and it neglected to take corrective action against those agencies when they did not improve. As a result of its inadequate supervision, the Federal Student Aid office failed to ensure its collection agencies abided by federal debt collection laws and the terms of their contractual agreements. Although it is primarily the Department's responsibility to ensure that its debt collection agencies follow the law, borrowers can privately enforce violations of the Higher Education Act through the Fair Debt Collections Practices Act.

## *The Department of Education on Lockdown*

Ideally, there should be a transparent process for the public to know how its tax dollars are allocated and whether government contractors are complying with the law. In fact, President Obama has committed his administration to achieving new levels of openness in government. Unfortunately, time and again, the U.S. Department of Education has failed to live up to this promise. Instead, the Department has protected and rewarded the interests of the private debt collectors it hires to collect from borrowers who have defaulted on their federal student loans.

In preparation for this report, NCLC sent a Freedom of Information Act (FOIA) request to the Department requesting a breakdown of the CPCS scores and the amount it paid in bonuses to the collection agencies in fiscal year 2012. The Department initially denied our request, providing only blacked out (redacted) information. NCLC eventually sued the Department of Education to obtain the documents and information. NCLC's recent FOIA experience is consistent with growing secrecy at the Department. In response to an earlier FOIA request that NCLC filed in August 2012, the Department provided a heavily redacted version of its Private Collection Agency manual although this document was previously publicly available on the Department's website.

The government's use of private collection agencies is incompatible with the equal access goals of the Higher Education Act and with the goal of giving borrowers fresh starts. The government funnels enormous profits to private companies to hound borrowers. This is short-sighted policy that fails to provide a way out for borrowers struggling to recover financially. Promoting paths to success for these borrowers is ultimately less costly for taxpayers than hammering borrowers for the rest of their lives with draconian collection tools. The needs of borrowers and taxpayers should be prioritized over profit for private companies.

## *Recommendations for Reform*

- 1. Eliminate the use of private collection agencies and move toward a comprehensive and individualized counseling model.** In deciding how to work with borrowers in default, the Department should study alternatives and create pilot projects with empirical research to test these options. The goal of this model should be to match the borrower with the right program based upon his or her circumstances, not just to collect the most money for the Department.
- 2. Reform the debt collection agency evaluation system so that performance is about more than dollars collected.** The evaluation system should ensure that government contractors follow the law and act in the best interest of student loan borrowers.
- 3. Eliminate conflicts of interest by using neutral entities to administer extra-judicial collection, such as administrative wage garnishment.**
- 4. Improve transparency and provide public information about the private debt collectors' performance, including complaints and any investigations or disciplinary actions taken against private debt collectors and the cost of outsourcing to them.**

5. **Congress and the President should improve the Department of Education's oversight of collection agencies and require the Department to make public information about how performance is tracked and the results.** The Department's Office of the Inspector General and the Government Accountability Office (along with Congress and the general public) should continue to monitor the Department's oversight.
6. **Hold collection agencies accountable through rigorous public and private enforcement.**
7. **Improve the complaint system so that student loan borrowers can easily file complaints about collection agencies.** The Department should follow the lead of other federal agencies such as the Consumer Financial Protection Bureau and create user-friendly complaint systems with easy to find instructions and contact information.
8. **End the Performance Based Organization experiment and set up a system that clearly puts borrowers first.**
9. **Expand online options so that borrowers can more easily access programs, such as rehabilitation, without needing to go through a third-party collection agency.**
10. **The Department of Education should improve its data collection system and make the information public in order to ensure integrity of data collected and the programs it administers.**